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Council Reference: **Rates - Levying**

3 November 2022

2022-23 Rate Peg Methodology Review
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
Sydney NSW 1240

Dear Sir/Madam

Submission to IPART Review of rate peg methodology

I refer to the IPART Review of rate peg methodology Issues Paper – September 2022 and on behalf of Council submit the following feedback/comments.

1. To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?

The Local Government Cost Index (LGCI) appears a reasonable approach as it reflects the costs and weightings of the sector at a particular point in time. Having said that, alignment of the Employee Benefits with the Local Government State Award would be more applicable (as mentioned in the issues paper) to be accounted for when determining the LGCI.

There are also opportunities to improve the information in relation to councils' costs through finalising Award negotiations at an earlier date than the current practice. For example, the current Award was finalised between the Unions and LGNSW approximately one week before the rate peg came into effect.

This would benefit councils in their discussions/decisions on any Special Rate Variation (SRV) applications as any Award increase above what is included in the council's long term financial plans can have a significant impact, as reflected in the 38.6% weighting of salary/wages in the LGCI.

2. What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?

While supportive of the concept of the LGCI, it is a challenge to reduce the time lag in the indicators, especially as councils need several months before the commencement of the financial year to undertake the requirements of the Integrated Planning & Reporting (IP&R) framework.

This could be improved by IPART considering adjusting the LGCI result to reduce the lag effect by reference to any notable changes in CPI to the most current period.

- IPART released the 2022/23 rate peg of 0.7% on 13 December 2021.
- Quarterly CPI figures are usually released in the month following the quarter. The annual change in December 2021 CPI was 3.5%; March 2022 CPI 5.1% and June 2022 CPI 6.1%.
- It was evident from the December 2021 and March 2022 CPI figures that 0.7% was substantially below actual costs.

As a suggestion IPART could:

- Publish the baseline LGCI in September each year for councils as a guide for preliminary budget planning.
- Check the CPI at the December quarter and advise councils if IPART considers there will be a possible shift from the initial LGCI announcement.
- Check the CPI at the March quarter and announce the rate peg limit in late April.

Councils could increase the underlying inflation factors in their operating budgets to align with the actual cost increase.

The amount of any increase will still be determined by IPART as they have done through the recent 2.5% ASV.

As the inflation factors will flow through to the subsequent LGCI – an adjustment for the advanced CPI would need to be made.

It should be noted that the rate peg has averaged between 2.1 and 2.41 over the last 12 years, with the last 2 years being an anomaly due to COVID.

3. What alternate data sources could be used to measure the changes in council costs?

Council in principle supports the current LGCI methodology with the inclusion of the CPI indicator as indicated above and the change in the employee costs inflator.

4. Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?

Whilst the population factor is in its infancy, the only improvements to be made, similar to the rate peg issue, is the 3 years lag in timing of population growth factor before it being included in the rate revenue.

5. How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?

It is noted that since 2018-19, the productivity factor has been set at zero as a default to recognise that improvements in productivity are already reflected, to an extent, in the ABS price indexes used to measure price changes in LGCI cost categories.

Additionally, most councils try to operate as efficiently as possible and free up funding for more initiatives, expectation and demands from their communities. The rate peg over many years has forced councils to review their operations. Having a double dip at the efficiency factor is not considered reasonable and equitable.

The productivity factor should continue to remain at zero for all future calculations or be removed.

6. What other external factors should the rate peg methodology make adjustments for? How should this be done?

There are specific circumstances to each council where a council may decide to provide new services to their local communities or undertake new activities to deliver existing services. It is then it is up to those councils to arrive at a means for funding of those costs, such as loan borrowings or special variations to rate revenue.

However, in cases where councils have been compelled to carry out additional services or activities (e.g. required by other levels of government or changes to the environment in which council's operate), then the rate peg methodology needs to have some flexibility to account for these additional costs of doing business.

7. Has the rate peg protected ratepayers from unnecessary rate increases?

This is a broad statement and hypothetical since it is not clear as to what would be considered an unnecessary increase and who the arbiter is of what is unnecessary.

Councils have lived in rate peg environment for a very long time and only apply for SRVs when there is a compelling need (councils would not consider SRVs for minimal increases of 0.5 to 1% from time to time).

It is also difficult to determine what councils would have done in an environment where there was no rate pegging.

However, councils are mindful of the impact of increasing rates on ratepayers, therefore the hypothetical differences may be minimal.

Our fear is that if lifting the rate peg may is seen by some, as an answer or response to addressing the fact that some statutory fees and charges and developer contributions have been capped by the States for many years. It would not be equitable for example for existing ratepayers to fund infrastructure provision (through an increase in their rates) for new developments because of Government imposed developer contribution caps or for existing residents through an increase in their rates to subsidise the true cost of assessing and determining a DA because statutory fees and charges that have not been indexed.

It is our view that IPART should assess the true costs of an average council provisioning infrastructure for greenfield and brownfield developments and that the developer contribution should reflect that average cost and be indexed yearly. The current cap of $20K and $30K respectively has been in place since August 2012 and has not been indexed. During that time materials and labour have escalated significantly.

Similarly, 2022 saw statutory fees and charges rise by 17%. The first increase in 22 years. Even with the 17% increase they do not reflect the true cost of providing the service and should also be assessed by IPART and indexed. By doing so, pressure will be taken off passing on the shortfall in costs to ratepayers and in turn driving cost of living pressures up for all.

8. Has the rate peg provided councils with sufficient income to deliver services to their communities?

The determinant regarding sufficient income to deliver services is the IP&R framework rather than the rate peg.

The objective of the IP&R framework is to have discussions with the community on the balance of rates versus services.

The SRV process allows for this after the appropriate community consultation.

In many respects it is the Statutory Fees and Charges that have not been indexed and the cap on Developer Contributions that have delivered insufficient income and placed resourcing constraints and forward strategic planning of asset constraints.

By way of concrete example:

Developer Contributions are an important source of income for local government to fund infrastructure for new development. Like fees and charges, these are also regulated or capped in NSW. In fact developer contributions have been capped since August 2012 at $20,000 per each brownfield dwelling and $30,000 for a greenfield dwelling; without regard to Council's costs in providing those services and infrastructure.

As a council we are required to forward plan and fund infrastructure to facilitate new development. In the last 15 years Tweed Shire Council has borrowed in excess of $130M to build a new water treatment plant and upgrade two waste water treatment plants to accommodate and service two new major developments of roughly 5,000 lots each. The then State Government introduced the Water Industry Competition Act (WICA) and for a time the proponent of the two major developments toyed with the idea of a private water and waste water scheme, whilst council was still required to make loan repayments on money borrowed to build the new infrastructure. The proponent is yet to release a single lot, resulting in Council not recouping developer contributions and not receiving revenue from the lots to pay down the capital. Further the interest component is unable to be recouped through the contribution so this is met by the existing rate base through an ever increasing water and waste water access charge, while ever the capital is not paid down.

It is widely known and accepted that capital costs and materials, land etc. has increased significantly since August 2012. The average lot in Tweed ten years ago sold for approximately $300,000 with developer contributions at $30,000 representing 10% of the land value. Today lots are in excess of $750,000 and contributions are still at $30,000 (4%). The State is of the belief that by restricting contributions payable to councils, it will open up supply and make land more affordable. This is a folly. If councils cannot forward plan and build infrastructure because they cannot fund it, they simply won't. In the longer term this will result in the necessary infrastructure for development not being available which will lead to a significant housing crisis with long lead times to resolve. Politically it is unlikely the shortfall will want to be passed on to existing rate payers. Nor should it.

To support my argument, Deloitte recently produced a report paper for DPE on the NSW Housing Status showing over the next 8 years, four out of five lots (66,000 lots) that could be developed do not have the required infrastructure to service those lots. 76% require sewer infrastructure, 70% require water and 50% require electricity and roads. Furthermore 27,000 lots have been identified by greenfield developers where the only constraint on supply is enabling infrastructure such as sewer, water, power or roads.

Now is the time for the developer infrastructure caps to be lifted and indexed annually to avert a future housing crisis even worse than what we are currently experiencing. Removing ordinary rate capping will not address this issue.

Whereas the developer contribution cap results in councils (ratepayers) having to subsidise the cost of infrastructure that then assists the profitability of the developer. It does not provide for cheaper housing supply, as recently evidenced in a Report released in August this year titled "Staged Release – Peering behind the land supply curtain" by Prosper Australia.

It should be noted that in the Tweed approximately 30% of our rate base are pensioners. It is simply nonsensical to have pensioners subsidising the cost of development. In the end it becomes a strain on the Commonwealth as cost of living pressures increase for those who can least afford it.

The combined impact of regulated service income and capping of contributions from developers, all with little regard to the cost of providing the services and infrastructure, is that councils are forced to cross subsidise these services and infrastructure costs from other revenue. In turn, this restricts the ability of the Council to deliver other essential services to the community including asset maintenance and asset replacement as well as investment in new assets, not funded through developer contributions, to service growth. It is in part this constraint that has led to the discussion on removing the ordinary rate

9. How has the rate peg impacted the financial performance and sustainability of councils?

The financial performance and sustainability of councils and their corresponding levels of services provided is a decision for each local government area.

However, it is not clear whether councils in high growth areas that receive assets from developers (with the subsequent operations, maintenance and renewal costs) receive sufficient funding from the rate revenue that the subdivision produces to cover these asset costs. Whilst supplementary levies and population factor increases have assisted in this regard, there could still be a shortfall.

10. In what ways could the rate peg methodology better reflect how councils differ from each other?

It would be more reflective of actual costs if the LGCI was calculated on a per council or per region basis, however this could be onerous. As an alternative, the LGCI could be varied based on disability factors similar to those used for the Financial Assistance Grants calculation.

11. What are the benefits of introducing different cost indexes for different council types?

The only benefit would be for more accurate data. It is debatable whether the outcomes would produce any significant differences.

12. Is volatility in the rate peg a problem? How could it be stabilised?

It is recognised that there are a number of changes that could be made to try to reduce the impact of volatility in the rate peg, but each method also has potential drawbacks.

It is therefore considered that the current system is generally reflective of the costs incurred by Council and should likely remain (though alignment of the Employee Benefits with the Local Government State Award should occur), but with provision for applications for an Additional Special Variation (ASV) to make up the shortfall in situations where the lag in the LGCI means that the calculated increase is lower than most councils have factored into their budgets and Long-Term Financial Plans (as was the case in 2022-23), or the alternative as outlined in Q2.

13. Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?

Refer comments Q2.

14. Are there benefits in setting a longer term rate peg, say over multiple years?

Whilst councils are obliged to adopt some estimate of rate peg amount for their long term financial plan, as outlined in Q2, the average rate peg amount has been relatively consistent, with the COVID impact creating an anomaly.

Councils have the opportunity to match their long term expenditures with rate revenue through the a multi year SRV.

15. Should the rate peg be released later in the year if this reduced the lag?

Refer comments at Q2.

16. How should we account for the change in efficient labour costs?

Refer comments to Q1 and Q5.

17. Should external costs be reflected in the rate peg methodology and if so, how?

Yes. IPART appears to deal with this adequately as it did for carbon pricing and the Emergency Services Levy.

18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved?

You could when councils are impacted by unforeseen costs such as the floods in the Northern Rivers.

19. What types of costs which are outside councils' control should be included in the rate peg methodology?

Refer comments to Q6.

20. How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?

Refer comments to Q2.

Yours faithfully

[redacted]

Date: 03/11/2022

Troy Green PSM
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